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UNITED STATES BANKRUPTCY COURT

WESTERN DISTRICT OF WASHINGTON AT SEATTLE

In Re:) No. 13-19746-KAO
CLI HOLDINGS, Inc. d/b/a ALYDIAN,)
Debtor.)

HEARING

Before the Honorable Karen A. Overstreet

January 10, 2014

Digitally Recorded Proceedings

Transcribed by: Shanna Barr, CETD
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1 A P P E A R A N C E S

2

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22 Also Present:

23 WENDY WALLACE
24 General Counsel for CoinLab

24

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1 January 10, 2014

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4 THE COURT: Good morning. Please have a seat.

5 MR. STEHLIK: Good morning, Your Honor.

6 THE COURT: All right. This is the time that I
7 have set for the case CLI Holdings, Inc. It's Case
8 No. 13-19746. It is a motion to establish bidding
9 procedures in connection with a proposed sale. So what
10 I'd like to do is start with appearances for the record.

11 Ms. Glynn Levin, we can start on your side.

12 MS. GLYNN LEVIN: Thanks. Deirdre Glynn Levin on
13 behalf of the debtor, Your Honor. And next to me is the
14 principal of my client, Peter Vessenes.

15 THE COURT: All right.

16 MS. GLYNN LEVIN: And he is available today to
17 testify orally if that's what the Court --

18 THE COURT: Okay. I don't normally -- wouldn't
19 normally take --

20 MS. GLYNN LEVIN: Yes.

21 THE COURT: -- testimony on my calendar, but go
22 ahead.

23 Ms. Simonyan?

24 MS. SIMONYAN: Your Honor, Tereza Simonyan on
25 behalf of Bitvestment Partners LLC. Good morning,

1 Your Honor.

2 MR. STEHLIK: Good morning, Judge. Jerry Stehlik
3 on behalf of Soule Investments LLC, a creditor.

4 MS. PEARSON: And, Your Honor, Jane Pearson here
5 this morning for CoinLab. And with me is general counsel
6 for CoinLab Wendy Wallace.

7 THE COURT: All right. Ms. Glynn Levin, it's your
8 motion, so why don't I turn the podium over to you first.

9 MS. GLYNN LEVIN: Good morning, Your Honor.
10 Deirdre Glynn Levin again on behalf of the debtor, and it
11 is the debtor's motion under Section 363 to seek the
12 approval for bidding procedures.

13 The Court has had some familiarity with this case,
14 but I will briefly review for the record what I think are
15 the key facts, and would like to go through -- then
16 through the law and the elements that the debtor believes
17 it has -- will be able to establish by the end of today's
18 hearing, has established on the record, and then I'd like
19 to address the two objections that were filed. One
20 objection was just filed yesterday at 5:00 p.m., so
21 suffice to say, there was --

22 THE COURT: Okay. Well, responses were due by
23 January 8th.

24 Yours was due later, right? Right. Because I
25 extended it, so it was timely.

1 MS. GLYNN LEVIN: Oh, I'm not saying it wasn't
2 timely, Your Honor, just that there wasn't an opportunity
3 to prepare a written reply. So to the extent I am able,
4 I am happy to address those in my oral arguments. But
5 there are some specific factual allegations that seems
6 important to -- may be important on the record to refute,
7 although in my view, those are not related to the sale
8 motion. They are -- there are other remedies available.

9 THE COURT: Okay. But in my view, they're the
10 elephant in the room.

11 MS. GLYNN LEVIN: All right.

12 THE COURT: Because if I can't trust the debtor to
13 operate post-petition in conformance with the code and I
14 can't trust the debtor's principal to use the monies as
15 required in a Chapter 11 proceeding, then we have a huge
16 problem. So I do need you to address those factual
17 issues today.

18 MS. GLYNN LEVIN: Well, I am happy to address
19 them, but they are -- I mean, they really require the
20 testimony because the basis for some of those objections
21 are in excerpts from a 2004 exam, which we saw, again,
22 yesterday for the first time after 5:00 p.m., and the
23 only way to really address them specifically is to be
24 able to allow Mr. Vessenes to testify.

25 THE COURT: Okay. Well, you can address them with

1 what you think his response will be to those contentions,
2 but I think fundamentally at issue in the case is whether
3 it makes any sense at all to sell equipment at this point
4 in time when the debtor appears to be generating
5 significant income through the mining of bitcoin.

6 MS. GLYNN LEVIN: Yes.

7 THE COURT: So you need to make that comparison
8 for me today.

9 MS. GLYNN LEVIN: Absolutely.

10 THE COURT: How much are we going to get for the
11 equipment versus how much is this debtor able to generate
12 on the monthly basis for the benefit of the creditors.

13 MS. GLYNN LEVIN: Oh, absolutely, Your Honor. And
14 there are -- this case is really all about time. You
15 know, you might say, well, it's really all about bitcoin
16 or it's all about, you know, a virtual currency, but in
17 some ways it's all about time, and it's sort of a ticking
18 time bomb. Not that it's going to explode, but rather
19 it's going to -- that the ability for the economic stream
20 and the business model is -- has changed so rapidly that
21 it makes it imperative to sell these rigs now. And in
22 the debtor's business judgment, it is the right time to
23 sell them right now, and I'll go through that in a little
24 bit more detail.

25 I wanted to make sure that Your Honor had an

1 opportunity to see the supplemental declaration of
2 Mr. Vessenes that was filed on --

3 THE COURT: I did --

4 MS. GLYNN LEVIN: -- January 6th. There are a
5 couple of exhibits to that declaration which I think are
6 really key and which perhaps with more elaboration can
7 help allay some of the Court's concerns.

8 So a little bit about the background to the --
9 again, we have a case that was filed on a fairly
10 expedited basis, November 1st, 2013, and the reason for
11 filing that, while it was alluded to, well, this is not a
12 case that was filed under sort of the typical debtor's
13 circumstances, in fact, it really was very typical in
14 that there was litigation that had commenced in the U.S.
15 District Court in New York, Southern District of New
16 York, and notably brought by the same creditor who is
17 objecting today, and that a stay of that proceeding was
18 necessary under 362. And that actually triggered the
19 filing, and in the course of the next eight to ten weeks
20 we've seen an evolution of facts which will lead me up to
21 the point today where we assert that there are more than
22 adequate grounds for a sale.

23 First of all, how exactly does the debtor operate?
24 Your Honor heard at the 2004 hearing on December 30th
25 that there is an underlying operating agreement which

1 memorializes the past operating protocols between one of
2 the owners of the debtor -- that's CoinLab, Inc. --
3 again, represented by Jane Pearson today -- who owns 65
4 percent of the common stock. The other owner is also a
5 creditor. And all creditor claims, by the way, have --
6 shall I say the deadline has passed. They have not all
7 filed, but the deadline has passed.

8 THE COURT: Deadline for claims.

9 MS. GLYNN LEVIN: Correct. The debtor is in this
10 arrangement, this operating agreement with CoinLab
11 whereby CoinLab sources out the vendors, sources out
12 the -- all the equipment, all the -- all of the parts,
13 really, for these --

14 THE COURT: Okay. But let me stop you for just a
15 second --

16 MS. GLYNN LEVIN: -- mining rigs --

17 THE COURT: -- because there's all kinds of stuff
18 going on in here, like there's ringing and there's
19 vibrating. So if everybody could just turn whatever
20 these things are off.

21 MS. GLYNN LEVIN: Let's make sure everything is
22 off.

23 THE COURT: It's sort of interrupting the flow of
24 Ms. Glynn Levin's argument. I think the buzzing has
25 stopped.

1 MS. GLYNN LEVIN: Under that operation agreement,
2 the -- CoinLab invoices the debtor and the debtor
3 reimburses CoinLab for all of its products, all of its
4 inventory, everything that has been --

5 THE COURT: So you're talking about their
6 prepetition operating agreement, right?

7 MS. GLYNN LEVIN: It's --

8 THE COURT: Because I think, according to the one
9 that Mr. Vessenes signed post-petition, it indicates that
10 they have operated under an informal working
11 relationship, so I don't believe I have seen a
12 prepetition written agreement between these two entities.

13 MS. GLYNN LEVIN: To the best of my knowledge,
14 there is no --

15 THE COURT: Okay.

16 MS. GLYNN LEVIN: -- written agreement, but that
17 has been the protocol. So the -- this operating
18 agreement memorializes the past and makes it clear as to
19 the companies' relative rights and responsibilities.
20 Under that arrangement, CoinLab invoices the debtor for
21 its direct costs plus an administrative fee up to ten
22 percent subject to a maximum of \$5 ,000 per invoice. All
23 of those invoices for the last year were turned over
24 in -- under the Rule 2004 production, and the SOFA --

25 THE COURT: To Bitvestment?

1 MS. GLYNN LEVIN: Yes. And the SOFA 3(b) and 3(c)
2 were amended also to ensure that there was an index of
3 all of those invoice dates, dates of payments and
4 amounts, and there is a -- there's a sort of an
5 evolution. At the beginning, those were paid in dollars.
6 Later they were paid in bitcoin, which is permitted under
7 the operating agreement. CoinLab was not paid out in
8 full. There were some points made about payments made
9 within the first few days prepetition --

10 THE COURT: Two days before the petition.

11 MS. GLYNN LEVIN: Prepetition. Those were based
12 on documented invoices, and CoinLab is, in fact, not paid
13 out in full. It is a general unsecured creditor, and
14 that's documented --

15 THE COURT: So doesn't that make it like a really,
16 really large preference?

17 MS. GLYNN LEVIN: They were -- one would need to
18 go through the preference analysis.

19 THE COURT: One would need to go through that
20 because a payment of in excess of a million dollars two
21 days before the petition date would certainly be the
22 subject of a concern over preference recoveries.

23 MS. GLYNN LEVIN: And we can certainly get into
24 that. In terms of the dollar amount, I'm going to be
25 really careful about talking about dollar amounts when --

1 because these exchange rates that have been used, I mean,
2 they fluctuate in -- with a great deal of -- there's a
3 great deal of variation in them, so to say that there was
4 a transfer made in a certain amount of dollars, at least
5 in the objections that I've seen, there is no real way of
6 calculating how those dollar figures came up. But it's
7 undeniable that those were amounts that were invoiced
8 over the prior couple of months. There has been a
9 regular pattern -- invoice and then payments in either
10 dollars or bitcoin -- and CoinLab -- I mean, CoinLab is
11 essentially the only provider of services, goods and
12 services.

13 THE COURT: But Ms. Pearson can represent
14 CoinLab --

15 MS. GLYNN LEVIN: Yes.

16 THE COURT: -- as to whether these were payments
17 in the ordinary course of business.

18 MS. GLYNN LEVIN: Indeed. Over the course of
19 approximately eight, nine months between December 2012
20 and August 2013, the debtor entered into this -- a number
21 of bitcoin service agreements, and essentially what those
22 were were presales with several customers. The debtor
23 brought a motion to reject those as executory contracts.
24 Only two of those customers objected and a hearing took
25 place on December the 6th. The Soule Investment hearing

1 was continued to next Friday, the 17th. Bitvestment made
2 its arguments, and the debtor's motion was denied. But
3 as to all the other customers, the executory contracts
4 have, in fact, been rejected under the Court's ruling.
5 And all of those creditors, again, except one, actually,
6 filed a proof of claim. There are, as well, two other
7 creditors: XRay Holdings, which is both a shareholder
8 and lender, has a \$3 million claim; and as, again, I
9 said, CoinLab has a trade credit of over \$400,000.

10 Let's get to the assets for the -- that are for
11 sale here. I hope I have done an adequate job in my
12 pleadings to articulate what these assets are, and I --

13 THE COURT: Well, I'm confused, to tell you the
14 truth, because I don't know what they're called. If I
15 look on Exhibit B, where do you actually find them? You
16 have Exhibit 1 that has a really detailed listing, and
17 some of the items on there have large values ascribed,
18 but where do I actually find the rigs on Schedule B?

19 MS. GLYNN LEVIN: I'm not sure that the rigs --
20 well, I should be careful about saying that.

21 THE COURT: And I only ask because in Exhibit N,
22 the operations agreement that Mr. Vessenes signed
23 post-petition, it says, "In order to implement the system
24 Alydian requires, and CoinLab is willing and able to
25 provide, use of CoinLab's computer hardware, mining rigs,

1 mining chips, inventory, hosting contracts, offices,
2 etc.," which implies to me that it's CoinLab which owns
3 the rigs and not the debtor. So then when I go to
4 Exhibit B, I'm wondering, where are they? What are they
5 called on here?

6 MS. GLYNN LEVIN: So I had the same questions when
7 I started working on this case, so let me explain. And I
8 might add that Schedule B was also amended, although it's
9 used, to add bitcoin balances held in accounts totaling
10 approximately \$5,000 as of the petition date. But
11 Your Honor is referring to, really, hardware. So the
12 process is that CoinLab goes out, sources all of this,
13 brings in all of these parts from multiple vendors. And
14 we're talking everything from the screws that the
15 computers are -- used to the chips. Very, very
16 complicated rigs that are then put together into systems.
17 The Schedule B outlined some inventory, which are the
18 parts which were not yet put into systems. In other
19 words --

20 THE COURT: Right.

21 MS. GLYNN LEVIN: -- the miscellaneous parts not
22 yet part of the -- of a launched system. The launched
23 systems actually at the time of the -- at the filing,
24 there really weren't that many launched systems. All of
25 those parts were in the process of being launched, and I

1 think as of --

2 Correct me if I'm wrong, around mid November, the
3 first systems were launched? Would that be correct?

4 MR. VESSENES: No. The first ones were launched
5 in July.

6 MS. GLYNN LEVIN: The first ones were launched in
7 July?

8 MR. VESSENES: And then we just finished -- should
9 have finished today, I think, with the last ones.

10 MS. GLYNN LEVIN: The last ones were finished
11 today. So it's an evolving process, but -- so what we
12 have for sale today is really sort of the culmination of
13 all the services and parts and intellectual --

14 THE COURT: Thirty-four systems.

15 MS. GLYNN LEVIN: Correct, 34 systems. The way
16 it's -- we have framed this for sale is rather by selling
17 the -- rather than selling them for system, in this
18 industry it's -- they are -- it's described as
19 "terra-hash," which is really power or, in my sort of
20 novice way of looking at this, is really kind of like
21 horsepower. It's the power that a system has.

22 THE COURT: Okay. But doesn't that mean that you
23 would then amend Schedule B again to turn this work in
24 process into 34 systems which are generating a total of
25 170 terra-hashes of power?

1 MS. GLYNN LEVIN: Actually, and approximately 200
2 now. I mean, if we were to have to amend Schedule B
3 every time we added power, I would probably be amending
4 that --

5 THE COURT: Right. Agreed.

6 MS. GLYNN LEVIN: -- multiple, multiple times
7 with --

8 THE COURT: Then how do I figure out how the
9 debtor values these systems, and why is it that CoinLab
10 claims to own rigs in this agreement that Mr. Vessenes
11 signed for himself and CoinLab? I mean, who --

12 MS. GLYNN LEVIN: I'm not sure which agreement
13 you're looking at.

14 THE COURT: Well, what I don't understand is we --
15 when we try to sell something in bankruptcy, we actually
16 have to demonstrate to the buyers what's being sold. And
17 I think this is a question Mr. Stehlik asks --

18 MS. GLYNN LEVIN: Yes.

19 THE COURT: -- on behalf of his client. Where is
20 the description of what is being sold, and does the
21 debtor have proof that the debtor actually owns what's
22 being sold?

23 MS. GLYNN LEVIN: Absolutely, Your Honor. I'm not
24 sure what agreement you're referring to that says that
25 the CoinLab owns --

1 THE COURT: I'm referring to the operations
2 agreement dated November 4th, 2013, between CoinLab and
3 the debtor, which was clearly signed post-petition, and
4 it's signed by Mr. Vessenes as the managing director of
5 the debtor, and it's signed by Mr. Vessenes as the chief
6 executive officer of CoinLab. And it says in the
7 recitals that CoinLab is willing and able to provide use
8 of its hardware, mining rigs, mining chips, inventory,
9 etc., making it sound like it's CoinLab that really owns
10 everything. And the only thing referenced in this
11 agreement that appears to be owned by the debtor is
12 called proprietary materials.

13 MS. GLYNN LEVIN: Well, those -- they may start
14 out being owned -- I mean, they are -- the parts which
15 then become launched into systems by the debtor start out
16 as being owned by CoinLab. CoinLab pays for them, for
17 the parts, but then they are effectively manufactured.
18 Like any manufacturing process, it's going through a
19 series of steps, and in our timeline, in our sequence,
20 once those are -- once they are invoiced and the debtor
21 pays for them, then effectively they're owned by the
22 debtor. I don't think -- certainly, counsel for CoinLab
23 can make these arguments as well, but there's no question
24 at all that the debtor owns these. The debtor is on the
25 record saying it's selling them. It has the rights to

1 sell them. No one else is claiming the rights to sell
2 them or own them.

3 THE COURT: So the debtor owns these 34 systems.
4 And I haven't seen the CoinLab invoices, so I don't know
5 whether -- I assume based upon the position you've taken
6 that they do not reserve a security interest in these
7 systems and that the monies they claim they are owed in
8 the proof of claim file are completely unsecured monies.

9 MS. GLYNN LEVIN: Absolutely correct. There is no
10 security.

11 THE COURT: All right.

12 MS. GLYNN LEVIN: There is no security instrument
13 at all here. Does that --

14 THE COURT: So based upon your evidence that's in
15 the record, what do you say is the value that the debtor
16 believes it can obtain by selling these 34 systems?

17 MS. GLYNN LEVIN: Okay. So let's go to value and
18 let's go to sale and let's go to the marketplace.

19 THE COURT: Right.

20 MS. GLYNN LEVIN: Because this isn't a selling --
21 these aren't selling used cars. There's no Blue Book
22 value. There's no appraisal where one comes in and
23 says -- you know, has an independent appraiser who has
24 special qualifications and says, "I think this is what
25 these are due." In fact, the expert -- probably one of

1 the worldwide experts in what these things are valued at
2 is sitting to my right. It's Mr. Vessenes himself. And
3 the objections about the value, I noticed, were not
4 supported by any evidence at all other than some
5 miscellaneous excerpts of his own testimony. There's no
6 other opposing testimony of any expert to say, you know,
7 you're selling these way too low or you're selling these
8 way too high so that, you know, no potential buyer could
9 ever potentially --

10 THE COURT: Well, how I'm --

11 MS. GLYNN LEVIN: -- would ever want to buy that.

12 THE COURT: How I'm looking at it, though, is if
13 the debtor has income of \$1.8 million for one month, the
14 first month of bankruptcy -- in other words, this is a
15 unique debtor because this debtor apparently doesn't
16 suffer any problems as a result of being in bankruptcy.
17 For example, a retail store everybody knows is in
18 bankruptcy, now the sales drop. It's not one of those
19 debtors. This is a debtor that seems to be able to make
20 a lot of money in the post-petition period, so what I
21 need to be convinced is that selling the -- this
22 equipment is going to yield more money than, say --

23 MS. GLYNN LEVIN: Absolutely.

24 THE COURT: -- three, four, five, six months worth
25 of operations. And so that's the question I'm asking is

1 where in the evidence can I find that more money can be
2 made by selling this than just generating bitcoin.

3 MS. GLYNN LEVIN: I do want to address that, and I
4 think the supplemental declaration of Mr. Vessenes and
5 the two exhibits chart that. And it does require a
6 little bit of sort of a combination of economics and
7 science in understanding the risk in the market. And
8 this is a very unique industry. This is not selling
9 stores. This is not selling coffee shops. This is
10 selling essentially the mining rigs, the hardware and all
11 of the software and all of the -- everything that goes
12 along with it to a third-party buyer, either in whole or
13 in parts, to a third-party buyer.

14 And the reason why we are looking at a key
15 change -- in fact, it's not a change right now. It's
16 been a change that has been happening over -- since the
17 debtor actually filed and perhaps even before. It's that
18 the industry is changing so rapidly. The evidence on the
19 record is that more and more miners are joining this
20 industry, way, way more than was ever anticipated, and
21 because more miners are joining this industry and because
22 there is a fixed number of bitcoins that may be mined
23 daily, the profit margin is going down for every miner.
24 Every miner is now having to work harder, and the
25 production -- the demands for production are that much

1 more difficult in order to produce it.

2 Now, yes, the debtor had an excellent December,
3 but the trend is not continuing. The trend is not
4 continuing to go up. In fact, the trend is going the
5 other way. The curve is going the other way, and that's
6 partly because of more and more parties entering this
7 mining space. And, also, the demand for bitcoin is also
8 very fluctuating. It's a -- again, and one could do an
9 entire course in economics just on the demand for bitcoin
10 and all the different factors that go into the demand,
11 everything from Chinese government to what's going on in
12 Germany to whether Overstock.com is accepting it. I
13 mean, there are lots of market forces pro and con.

14 The key thing for your -- for the Court's concern
15 here today is -- and perhaps we should turn to that
16 declaration -- is to look at that and to see if I can
17 answer that, look at those exhibits or offer my client to
18 be able to answer them, answer those questions.

19 So let's look at Exhibit A. It's one that is
20 Document 92-1 on -- in the docket. So if we look at the
21 projection from January 8th going -- of last year, the
22 mining difficulty, which is a function of how many -- is
23 a function of a number of factors, but including how many
24 other miners there are in the market, is very, very low.
25 It's practically at zero. If you look over the next six

1 months, it starts to increase very slowly. It's now
2 going up. We see over at around July 11th it's now going
3 up. It's starting to climb. And by -- say by the
4 petition date, the scale is now increasing, and the
5 figure in our record is that the increase of mining
6 difficulty is now at 43,000 percent, which is a figure I
7 don't think I've ever used before in any, ever, context.

8 Exhibit B shows -- goes to another economic
9 question. It goes back to the question of hardware, the
10 mining rigs. What about those? They are being
11 manufactured by other companies all over the world. A
12 couple were referenced in Mr. Vessenes's declaration.
13 What's happening with the price of mining rigs? Let's
14 look at that, Exhibit B. The mining rigs, which is what
15 we have to sell here, just in the last 30 days -- this
16 graph starts December 8th, 2013, and it ends just the
17 first week of January 2014. Again, we have a clear
18 decline here. And there's no argument that this is not
19 objective evidence. Again, Mr. Vessenes can elaborate --

20 THE COURT: I want to ask you about the monthly
21 report that was filed and how it lists the equipment.
22 The November report listed deployed systems with a
23 value -- or, you know, maybe this is a cost value, but it
24 says \$547,176.

25 MS. GLYNN LEVIN: Yes. Cost value.

1 THE COURT: Right. And then it showed accumulated
2 depreciation of \$364,412. Well, that's a lot if what
3 you're telling me is they only just deployed these
4 systems. So now the debtor says total fixed assets
5 182,765. So I'm still trying to figure out, you sell
6 these rigs, what do you get? Do you get 400,000? Do you
7 get 1.5 million?

8 MS. GLYNN LEVIN: But let --

9 THE COURT: Do you get 10 million?

10 MS. GLYNN LEVIN: So --

11 THE COURT: How do I compare monthly revenue of
12 \$1.8 million to what you're going to get if you sell the
13 equipment? I mean, I agree with you. It's difficult to
14 value, but you're asking that the debtor just be able to
15 go out and sell the equipment, and we have no idea what
16 we're going to get for it and --

17 MS. GLYNN LEVIN: So let's go to that. And there
18 are --

19 THE COURT: Then maybe we should provide that if
20 we don't get more than we want, we just say: Forget it.
21 We're not going to sell it this way.

22 MS. GLYNN LEVIN: I mean, there could be that
23 contingency. But let's address those two points. First
24 of all, shouldn't the debtor just continue to work these?
25 Well, clearly on the record we've got some very -- we've

1 got some highly technically trained people. Not that it
2 necessarily requires, you know, rocket scientists to
3 operate these, but we do have very highly technically
4 trained people who have been working, who have put in
5 their blood, sweat and tears to make these things
6 operate, and they are on the record to say they're only
7 staying until the end of January. So that --

8 THE COURT: So let me understand this clearly,
9 because according to Ms. Simonyan's pleadings that she
10 put in, Mr. Vessenes paid them 300-and-some-thousand
11 dollars to stay, and that was just for one month? Or is
12 that --

13 MS. GLYNN LEVIN: They actually --

14 THE COURT: Are those facts just completely wrong?

15 MS. GLYNN LEVIN: The actual bonuses that were
16 paid in December were only a total of \$46,000 to two of
17 the three members of the team. The third member of the
18 team, Hans Olsen, who has -- was projected to receive a
19 \$54,000 bonus, did not. Did not receive that. Has not
20 been paid that bonus. So two of the underlying --

21 THE COURT: So I'm trying figure out --

22 MS. GLYNN LEVIN: Yes.

23 THE COURT: -- how in a Chapter 11 proceeding the
24 debtor pays random bonuses without any court approval at
25 all and without demonstrating that there's a contract in

1 place.

2 MS. GLYNN LEVIN: Well, they --

3 THE COURT: How does that happen?

4 MS. GLYNN LEVIN: They --

5 THE COURT: I haven't read the bankruptcy code
6 provision, but there is even a provision in the
7 bankruptcy code for the payment of incentive
8 compensation.

9 MS. GLYNN LEVIN: There are, and they are not
10 employees of the debtor. They are employees of CoinLab.

11 THE COURT: So that concerns me even more. Now
12 what you're saying is the debtor agreed to pay
13 significant incentive compensation to employees of an
14 insider without any court approval at all.

15 MS. GLYNN LEVIN: Well, we can certainly go back,
16 and if the Court thinks this is important we can
17 certainly go back and outline of -- it all and --

18 THE COURT: I think it's important, because what
19 I'm not understanding is where Mr. Vessenes draws the
20 line between what he can do outside of bankruptcy and
21 what he can do inside of bankruptcy.

22 MS. GLYNN LEVIN: I'm certainly happy to --

23 THE COURT: And what he can't do is spend money of
24 the estate outside the ordinary course of business
25 without court approval.

1 MS. GLYNN LEVIN: I'm certainly happy to put that
2 forward. But to be clear, these -- this is the team that
3 is operating them, and without any of them, without one
4 of them, the systems don't go. So it's a little --

5 THE COURT: In which case we would have had that
6 in a motion --

7 MS. GLYNN LEVIN: Yes.

8 THE COURT: -- with declarations. People could
9 have objected or not and agreed with you that these
10 people were critical, but instead we find out because
11 Ms. Simonyan or somebody else from her firm took the
12 deposition of Mr. Vessenes and he had to say what
13 occurred. I guess that's --

14 MS. GLYNN LEVIN: Again --

15 THE COURT: -- the problem.

16 MS. GLYNN LEVIN: -- we're talking the total that
17 have actually been paid of bonuses is \$46,000 to two
18 people at Christmastime. So I am certainly happy to put
19 that before the Court and make full disclosure, and the
20 Court can look at that, can look at the basis of the
21 contract. CoinLab can explain why these are employees --
22 well, two of them are employees of CoinLab and one is an
23 independent contractor. There were January bonuses
24 projected or allowed for in a budget, but nothing has
25 been paid. And that's why -- I mean, that's why it's

1 really unfair to have the 2004 excerpts being thrown
2 around without the entire transcript. We don't even have
3 the entire transcript. It's not even a formal
4 transcript. It's a draft. So those are the facts. And
5 I'm certainly happy to -- again, to put Mr. Vessenes on
6 the stand, and he can testify as to those facts. The
7 Court doesn't have to take my word for it.

8 Let's go to the question of what are these things
9 worth. Again, we don't have an independent valuation.
10 There is no Blue Book. There is no appraisal standard
11 for these. This is -- these are, in fact, sort of custom
12 made mining rigs. So where does one go to get a pulse on
13 what that's worth? Well, Exhibit B in Mr. Vessenes's
14 supplemental declaration has some graphing on what these
15 things are being sold for. And this is a very highly --

16 THE COURT: Well, let's read the graph, then.
17 Read it for me.

18 MS. GLYNN LEVIN: Okay.

19 THE COURT: And tell me what it says. What it
20 says is there's a -- there's 20,000 -- I mean, I have to
21 look at it online. So what does it actually say is the
22 per-system price that could be received for the systems?
23 Is it \$30,000?

24 MS. GLYNN LEVIN: Can I have my client help
25 interpret this chart? Because it's pretty technical.

1 THE COURT: Well, I mean, it's tiny, for one
2 thing. I can't see it. If he's the expert, you know,
3 his declaration should just say, "I should be able to
4 sell these for \$30,000 a system."

5 MR. VESSENE: If I -- can I finish --

6 MS. GLYNN LEVIN: Well, Your Honor, they're not
7 being sold per system.

8 THE COURT: Okay.

9 MS. GLYNN LEVIN: They're being sold -- the sale
10 is framed in terms of terra-hash. And the terra-hash, as
11 I said, is really a measure of power, like horsepower,
12 because that's the way it's measured. It's not "I'm
13 buying Computer A or Computer B."

14 THE COURT: So we know how much power we have to
15 sell.

16 MS. GLYNN LEVIN: Approximately 200,000
17 terra-hash.

18 THE COURT: Right.

19 MR. VESSENE: 200. 200.

20 THE COURT: So at what price?

21 MS. GLYNN LEVIN: Approximately 200,000
22 terra-hash. But we --

23 THE COURT: For?

24 MS. GLYNN LEVIN: In our motion, we have proposed
25 that a minimum bid is \$2,000 per terra-hash, and we spent

1 some time looking at what really would be a reasonable
2 minimum bid. And, again, keeping in mind even at the
3 time that we filed the motion to today we could have had
4 fluctuations in the market for what a terra-hash is being
5 sold for in the open market. We came up with a minimum
6 bid of \$2,000 because in our business judgment, and that
7 has not been challenged, in the debtor's business
8 judgment that is a good entry level point for getting as
9 much interest as possible from perspective purchasers.
10 This auction that we are going to propose -- and I have a
11 supplement to our order -- this auction is actually going
12 to be a worldwide auction, and we're actually proposing
13 to -- and I have actually spoken to the Court's very
14 favorite auctioneer to bring that into -- bring that sort
15 of live.

16 THE COURT: Murphy's going to auction --

17 MS. GLYNN LEVIN: Mr. Murphy --

18 THE COURT: -- mining rigs?

19 MS. GLYNN LEVIN: I have spoken to Mr. Murphy, and
20 he said he is available and ready to do it. He is -- I
21 mean, there's nobody else who has any more expertise in
22 auctioning generally than Mr. Murphy, and it seemed to me
23 really -- it seemed to be incumbent on the debtor to
24 ensure that we had sort of a neutral process because --

25 THE COURT: So there isn't some clearinghouse for

1 these sales?

2 MS. GLYNN LEVIN: There is no clearinghouse for
3 these sales. And, really, in order to achieve the best
4 price, we really do need to make sure that it's noticed
5 out worldwide, in addition to having Mr. Murphy as a
6 neutral to help facilitate this auction and to assure
7 that every possible bidder gets the opportunity to come
8 in so we know who they are all, all their requirements
9 for qualified bidders.

10 In addition to that, we have engaged a company out
11 of Florida to help do the PR work, and that contract has
12 been executed today, and we will be asking Your Honor to
13 approve that company to -- as a professional to do the PR
14 and marketing to make sure it gets out there. And they
15 are used to doing this on a sort of crisis, immediate
16 process to put the news out on the Web, to do interviews,
17 to do press releases, to do whatever it takes to get that
18 information out there. And this potential purchaser base
19 is -- I mean, these aren't people hanging out in their
20 offices. They're not venture capitalists.

21 THE COURT: They're not insiders, as
22 Ms. Simonyan's client believes.

23 MS. GLYNN LEVIN: And then -- there is not one
24 interest from any insider as far as I know in this.
25 There have been -- I mean, there has been contact for a

1 number of potential purchasers, and the one thing that
2 Mr. -- that is not -- was not put in the record is
3 Mr. Vessenes's testimony from his 2004 exam that said he
4 is not making an offer, CoinLab is making an offer, so
5 the -- and whether XRay makes an offer, I don't know. It
6 doesn't have counsel.

7 But the whole premise that this is designed
8 somehow to -- because it's some sort of an insider
9 collusion and only people with the special knowledge and
10 the special handshake know how to make a bid, I mean,
11 it's -- to be honest, Your Honor, it's baseless. This
12 debtor has no other purpose in selling these other than
13 to maximize the return to creditors. And as I said, the
14 alternative -- and we're on January 10th. The
15 alternative is that in 21 days, approximately, the staff
16 who are going to continue to operate these and maintain
17 it and run it and track the records and, you know,
18 produce the bitcoin production, they're going to be gone.
19 So at most, if we don't have a sale, we have 21 days left
20 of production.

21 Going back to the numbers. And this -- these
22 large numbers were sort of thrown around: "Oh, there's
23 millions of dollars of production." Again, it's a play
24 on words. The net is not millions and millions of
25 dollars. The debtor has significant cost. Each of the

1 hosting locations is -- are very pricey leases. They use
2 massive amounts of power.

3 THE COURT: Well, let's talk about the leases --

4 MS. GLYNN LEVIN: All right.

5 THE COURT: -- just for a second. Because I got
6 the impression when we were here before that the leases
7 were already something that CoinLab had in place, yet
8 when I looked at the declarations filed, your
9 declarations, I see that only the Sabey lease was in
10 place in August. The Wow -- one Wow lease for 18 rigs
11 was allegedly entered into on the petition date between
12 CoinLab and the lessor, and the second Wow lease was
13 entered into, according to the declaration, on
14 December 19th, so well after the petition was filed.
15 So --

16 MS. GLYNN LEVIN: So --

17 THE COURT: -- now we have CoinLab, which
18 supposedly has the right to charge the debtor dollar for
19 dollar for expenses, entering into what appear to be very
20 expensive leases post-petition, and I was just wondering
21 what the lease rates were before the case was filed
22 because these are --

23 MS. GLYNN LEVIN: The --

24 THE COURT: -- new leases. These aren't leases
25 that were in existence as of the petition date.

1 MS. GLYNN LEVIN: They have all been negotiated
2 with some hard-fought negotiating, as I understood --

3 THE COURT: Well, how do you know that?

4 MS. GLYNN LEVIN: I --

5 THE COURT: I mean, have you been in --

6 MS. GLYNN LEVIN: I have not been --

7 THE COURT: Have you been a part of these
8 negotiations?

9 MS. GLYNN LEVIN: I have not been directly.

10 THE COURT: Because this is -- one of them is
11 \$198,000 a month.

12 MS. GLYNN LEVIN: That is the cost of --

13 THE COURT: For ten rigs.

14 MS. GLYNN LEVIN: That is the cost of -- these
15 things don't go in an office building. These things go
16 in very highly specialized environments that have proper
17 cooling, that have proper temperature control, that have
18 proper security.

19 THE COURT: Okay. But if you just stop and think
20 about it, you can see how now I would want to have some
21 background information about what the debtor was paying
22 before so that I know that the debtor and CoinLab haven't
23 significantly trumped up the value. Because I don't see
24 any of this on the debtor's monthly report for November.
25 Where is the payment --

1 MS. GLYNN LEVIN: That's --

2 THE COURT: -- made to CoinLab on the debtor's
3 November monthly statement?

4 MS. GLYNN LEVIN: So the leases are between
5 CoinLab --

6 THE COURT: Right.

7 MS. GLYNN LEVIN: -- and these third parties,
8 Sabey and Wowrack.

9 THE COURT: But the debtor pays CoinLab.

10 MS. GLYNN LEVIN: Yes.

11 THE COURT: And the debtor did --

12 MS. GLYNN LEVIN: They are --

13 THE COURT: -- pay CoinLab.

14 MS. GLYNN LEVIN: They are passed through. The
15 leases -- there may be some new leases, but they -- there
16 weren't --

17 THE COURT: Right.

18 MS. GLYNN LEVIN: There weren't earlier leases for
19 the same space that were then changed or modified. These
20 are new leases. Remember, these are things that are
21 being launched over time. So there may have been one
22 lease on a month. Then one --

23 THE COURT: So it's amazing because on the
24 petition date the debtor had only six rigs that were
25 operating -- well, plus 18, because that happened right

1 on the petition date, and then ten new rigs were placed
2 into service in the middle of December. That's what --
3 how this works?

4 MS. GLYNN LEVIN: Yes.

5 THE COURT: Okay. So then going back to the
6 November monthly statement, I was still looking for a
7 line item for the invoiced payments that the debtor makes
8 to CoinLab for those past due expenses, and I don't know
9 which line item it's on. That's all I'm saying.

10 MS. GLYNN LEVIN: Would Your Honor like me to look
11 for that now?

12 THE COURT: Well, somebody should tell me, yeah,
13 because I'm trying to figure out -- I was, like you,
14 trying to figure out, okay, I assume \$1.8 million isn't
15 the net monthly income. I assume there were some
16 expenses that need to be deducted from that. And then
17 when I looked at the expenses, I didn't really see -- I
18 see an officer salary of \$20,000. I mean, is that one
19 person?

20 MS. GLYNN LEVIN: That's Mr. Vessenes' salary,
21 which was not paid.

22 THE COURT: And he makes \$20,000 a month?

23 MS. GLYNN LEVIN: As I said, that's Mr. Vessenes's
24 salary, which was not paid. He is not paid. He has not
25 received a dime since the --

1 THE COURT: So rent I see 3,058. General and
2 administrative, 43,000.

3 MR. VESSENE: Here's, like -- so here, example,
4 these are the Wowrack. Like, there's Vessenes A and E.
5 That's a Wowrack bill. And then here -- and this is what
6 we gave to the trustee -- here are the budget estimates
7 for hosting.

8 MS. GLYNN LEVIN: Okay. So I'm --

9 THE COURT: So there's a loss of \$66,913, but only
10 because there was no profit shown on the original
11 November statement, and then depreciation is the other
12 big number on here.

13 MS. GLYNN LEVIN: Right.

14 THE COURT: So where's CoinLab?

15 MS. GLYNN LEVIN: So the -- I think what I'd like
16 to do, Your Honor, is turn over a document that has
17 actually already been produced in the 2004 exam. It's
18 actually Bates stamped here at the bottom, and it's a
19 budget that was produced to the U.S. trustee, who is here
20 today, by the way, and he has told me he's not objecting
21 today 's motion. I think he can vouch for the fact that
22 we turned out -- we turned over this budget. May I pass
23 up a copy to Your Honor?

24 THE COURT: Go ahead.

25 MS. GLYNN LEVIN: So --

1 THE COURT: So it's one I haven't seen, right?

2 MS. GLYNN LEVIN: I think that this is not -- I
3 don't believe this is part of the -- of the U.S. -- of a
4 monthly operating report. It may have been. We were
5 asked to turn it over. I just can't recall. So this is
6 Bates stamped.

7 THE COURT: So Ms. Simonyan has seen it?

8 MS. GLYNN LEVIN: Yeah. It's Bates stamped 11 --
9 CLI Chapter 11, and it's numbered starting at 115 through
10 136. And this is probably a -- well, it's about 30 or --
11 let's say 20 or so pages of probably well over 2-, maybe
12 3,000 pages that were produced under the 2004 exam.

13 THE COURT: So this shows what the actual payments
14 are supposed to be.

15 MS. GLYNN LEVIN: This were the operating
16 expenses, yes.

17 THE COURT: So it's hosting expense. That's the
18 line item. Contractors.

19 MS. GLYNN LEVIN: Yes. Hosting expense.

20 THE COURT: Hosting expense.

21 MS. GLYNN LEVIN: It's the fifth line down.

22 THE COURT: Wow, severance of \$105,000 in December
23 and January?

24 MS. GLYNN LEVIN: Again, as I articulated before,
25 the only severance that was paid was the 40- -- I think I

1 said \$46,000. That was budgeted. It was set aside.
2 It's still sitting there. It's been untouched. Ensuring
3 that the key staff people stay on is a pretty
4 important --

5 THE COURT: Okay. Well, I want to keep arguing
6 that one because --

7 MS. GLYNN LEVIN: Right.

8 THE COURT: -- what I think is it violates the
9 bankruptcy code to pay severance and bonuses without a
10 motion and court approval. So we're going to have to
11 get -- I'm going to have to get past that --

12 MS. GLYNN LEVIN: I will certainly make sure --

13 THE COURT: -- with this debtor or the case is not
14 long for debtor in possession or we'll have to have some
15 kind of trustee, but there have to be some limits on what
16 the debtor can do with the money that follows the
17 bankruptcy code. That's all. I mean, I see it on here
18 on this budget. This was not a budget that --

19 MS. GLYNN LEVIN: It's on --

20 THE COURT: -- I saw or ever approved, so...

21 MS. GLYNN LEVIN: It's on a budget. It is not --
22 as I said, the only -- I mean, they were basically
23 Christmas bonuses to two staff employee people in
24 December. Nothing has been paid in January. Nothing.

25 THE COURT: Okay.

1 MS. GLYNN LEVIN: Mr. Vessenes has been paid
2 nothing.

3 So you were -- the Court was concerned about the
4 hosting and exactly how that works?

5 THE COURT: Well, is that the -- so the CoinLab
6 line items are contractors, right? Is that one? 59,750.

7 MS. GLYNN LEVIN: CoinLab line items.

8 THE COURT: Contractors. I assume those are
9 the -- well, I'm trying to figure out what are the --
10 which line items show the pass-through expenses, and I'm
11 guessing contractors would be.

12 MS. GLYNN LEVIN: All of them.

13 THE COURT: Right.

14 MS. GLYNN LEVIN: All of them.

15 THE COURT: So hosting expense, contractors.
16 What's NRE?

17 MR. VESSENEs: Nonrecurring engineering costs for
18 installation of systems.

19 MS. GLYNN LEVIN: There we go. Nonrecurring
20 engineering costs for installation of systems.

21 THE COURT: And administrative services?

22 MS. GLYNN LEVIN: It's explained in the column on
23 the right-hand side.

24 THE COURT: Oh, okay. And administrative
25 services. Travel?

1 MS. GLYNN LEVIN: There are -- members of the team
2 work in various places, and the systems are hosted in
3 various places. They're not all in one place. They're
4 in Eastern Washington. They're in Western Washington.
5 There are offices in Portland. So it requires travel and
6 it requires people to be on site to take care of this
7 and --

8 THE COURT: And then small office rent.

9 MS. GLYNN LEVIN: Very small office rent.

10 THE COURT: All right.

11 MS. GLYNN LEVIN: I mean, I really want to make
12 sure that the Court is satisfied that there isn't some
13 hiding of information. I mean, this is as transparent
14 as --

15 THE COURT: Well, I'm not satisfied that there
16 isn't some hiding of information, but I'm willing to -- I
17 mean, what we're here today is -- what we're doing is
18 we're here today to talk about whether or not the
19 debtor's equipment should be sold versus continuing to
20 operate the business.

21 MS. GLYNN LEVIN: Yes.

22 THE COURT: I know full well that our -- one of
23 our panel trustees is likely not going to be able to
24 operate this business, so we need to find a way to get
25 some money to creditors that makes sense. But if you're

1 asking me am I satisfied with the credibility of
2 Mr. Vessenes? No, I am not. And so what I need is to
3 get to a believable scenario for selling the equipment
4 and realizing more income than the debtor can realize by
5 operating even for a couple of months. And that's why
6 the income and expenses are important to me, because, I
7 mean, Ms. Simonyan is going to get up, and she's going to
8 argue that this debtor can make more money by operating,
9 and I still can't get to November, because the way
10 November worked was there was an amended report filed
11 that only had income on it. So am I just supposed to
12 substitute that number --

13 MS. GLYNN LEVIN: There --

14 THE COURT: -- gross sales, and then do the math,
15 and that's what the net -- what is the debtor's net
16 profit for November?

17 MS. GLYNN LEVIN: That's because there were
18 invoices issued from CoinLab to the debtor in the month
19 of November, but they were not paid. So the expenses
20 that were actually paid, disbursed dollars or coins
21 actually paid out in the month of November 1 through 30?
22 The answer was zero. They have been paid out in
23 December.

24 THE COURT: So they --

25 MS. GLYNN LEVIN: That report's not due yet.

1 THE COURT: I see. So I don't -- you don't know
2 or nobody's figured out yet what the net profit for
3 November and what the net profit for December is?

4 MS. GLYNN LEVIN: We will -- we can certainly give
5 estimates. And, again, Mr. Vessenes is here. I
6 understand the Court's concerns, Your Honor, but to do --
7 I mean, we were operating -- I mean, this is as close to
8 rotting fish as you get. And any case where a lawyer,
9 where a counsel comes in and says, "My client has rotting
10 fish, can we please sell it," yes, everybody's
11 credibilities gets scrutinized because of the heightened
12 time and the urgency of it all. But if there is any
13 concern about Mr. -- about there not being sufficient
14 documentation in the record, well, I will take that upon
15 myself. I would certainly hate to have my own client's
16 credibility be questioned when it -- if it was my fault.

17 THE COURT: I mean, my preference would certainly
18 be that CoinLab shouldn't be paid anything except by a
19 motion and order of the Court, or somebody needs to be
20 looking at the invoices. Because this is a lot of money
21 being transferred to what is clearly an insider.

22 MS. GLYNN LEVIN: Yes.

23 THE COURT: Before and after bankruptcy with
24 virtually no oversight by anyone, and that concerns me.

25 MS. GLYNN LEVIN: I understand, Your Honor.

1 THE COURT: I don't know how legitimate these
2 expenses really are because what I see is a debtor that
3 has absolutely zero existence, zero -- the debtor is
4 nothing. The debtor has -- doesn't have -- I can't tell
5 whether the debtor has the assets. Mr. Stehlik raised an
6 issue about who owns the -- you know, who owns the
7 technology. I don't know what it takes to prove what the
8 debtor owns. The debtor has no employees. The debtor
9 has no office. The debtor has nothing. And so I want to
10 make sure that when we do this worldwide advertising we
11 are not misrepresenting to the world what we have to
12 sell, because the integrity of the bankruptcy process is
13 at stake.

14 MS. GLYNN LEVIN: Clearly, Your Honor, and --

15 THE COURT: So that's -- and then I want to
16 compare apples to apples. In other words, how much did
17 this debtor make in November and December, and how much
18 can the debtor make by selling rigs? If you tell me the
19 minimum price is 2,000 per terra-hash, all right, I've
20 got \$400,000.

21 MS. GLYNN LEVIN: That's right. That's going to
22 be the minimum if all of the terra-hashes are sold.

23 THE COURT: Maybe that's all we get, 400,000.

24 MS. GLYNN LEVIN: Our estimates is that is a
25 really good entry level. That's a floor. But we

1 anticipate that we're going to have purchasers -- more
2 than one purchaser, because as I said, the
3 terra-hashes -- the systems are divided among more than
4 one hosting place, and a -- one purchaser might say, "I
5 want, you know, a given number of terra-hashes, and I
6 want to operate them in -- you know, at, say, these --
7 location in, you know, this place," and so on and so
8 forth.

9 To the extent that we were talking about what can
10 the debtor -- what could the debtor mine if all systems
11 continue to go ahead as is, no changes? I really would
12 like to put Mr. Vessenes on the stand because I can't
13 testify. These are projections that an expert needs to
14 make, and we are --

15 THE COURT: Well, you have the profit and loss
16 statement that you just handed me. You have a budget.
17 But I guess that doesn't have a -- it has 2013 and it has
18 2012. It goes to January '13, right? But if you take
19 out the things that aren't appropriate at all, like
20 \$105,000 in severance pay, that changes. Capital
21 expenditures. Inventory write-offs. I mean, this
22 doesn't sound like the budget that I would expect for a
23 Chapter 11 debtor, I guess. I don't understand the
24 budget, but -- operating expenses.

25 MS. GLYNN LEVIN: I want to address the Court's

1 question, because it's a good one and it's a sensitive
2 one because, as we said, this is really an industry and
3 this is a company that is as transparent as you possibly
4 could get because even its accounts are out there
5 available for the world to see.

6 One of the exhibits that came up in the
7 declaration was a set of records that Bitvestment had
8 created showing transfers and so on. I mean, it's pretty
9 available for most -- for any kind of savvy user to
10 figure out what is mined and what are being held in
11 various accounts. The concern and the sensitivity part
12 has to do with -- is connection with the sale, in that
13 the sale, as we propose, that these rigs will be on an
14 "as is/where is" basis, and there are going to be -- are
15 not -- while we have records as to what mining production
16 has been, we don't want to be making representations as
17 to what mining production will be. In this industry, no
18 one could make such predictions. It's not like you're
19 selling a, like a -- you know, you're selling a -- car
20 sales.

21 THE COURT: Okay. But I understand that. So
22 there are no reps and warranties about how well these
23 machines will do.

24 MS. GLYNN LEVIN: Correct. And in the same way --

25 THE COURT: We just know how much power they have.

1 MS. GLYNN LEVIN: We need to know how much power
2 they have, and any -- we are anticipating that the buyers
3 of -- the prospective buyers are going to have that level
4 of understanding. They will probably be individuals and
5 companies who are already in the bitcoin mining industry
6 and who are already operating, but want to expand their
7 capacity. So that's what we're anticipating. I -- we're
8 not going to be selling to someone who can't decide
9 whether they want to buy a 7-Eleven or a mining rig. I
10 mean, these are going to be people from all over the
11 world who are already in this industry. And it's a
12 finite industry, although it is growing, which is part of
13 the whole premise for how the business model is changing.

14 I'd like to make sure I address the elements of
15 the sale. Really, we have been talking for the last hour
16 or so about whether a sound business reason exists for
17 the proposed transaction. And in the record, between
18 Mr. Vessenes's declaration, supplemental declaration, and
19 Hans Olsen's declaration, the net conclusion that the
20 debtor has come to is that these mining rigs need to be
21 sold.

22 And I want to address the objection because --
23 both the source of the objection and sort of the merits
24 of the objection.

25 Why is it that we have one of many creditors --

1 well, two, but basically one substantial objection of
2 many creditors that is objecting and none of the others
3 are? We have one and why is that? We have a very, very
4 litigious plaintiff in New York, who did not get their --
5 who did not get what they want. They did not get the
6 specific performance, which is what they've been asking
7 for, and that's what's underlying this. They believe,
8 and I will let Counsel speak to that, but my
9 understanding is that Bitvestment believes that it has an
10 inherent right under its contract to specific
11 performance, and if it were -- if it received the rights
12 it was asking for that it felt were its remedy, it would
13 demolish the claims of every other creditor here. Its
14 claim, which has absolutely no support, I might add, is
15 for \$8 million, which is just such a beautiful round
16 number it's sort of hard to believe that it has any
17 legitimacy to it.

18 All of the other claims -- we have a claim for
19 loans, a large one, 3 million, and we have claims in
20 various amounts, some based on the exchange rate of the
21 bitcoins as of November 1st, others I can't really tell.
22 I mean, we just -- we have a -- sort of a range of
23 claims.

24 But if we sort of step back and say: Wait a
25 second. Why is Bitvestment objecting here? I mean, yes,

1 they want the debtor to continue to pump out those
2 bitcoins as much as possible. The part that they do
3 not -- that they are missing or the deceit here is that
4 there is a huge cost to be able to do that, and we have a
5 finite timeline here in that the actual service people,
6 the software engineers who are on their -- on the ground
7 to do this say they're going to stop doing it as of the
8 end of January. So I do want to look at that, these
9 objections in that context.

10 The -- we addressed the sale price, and I think
11 we've been addressing the good faith of the process
12 throughout, and I can address my concerns or my prospects
13 later as to how we would envision an auction.

14 As to the element of reasonable and accurate
15 notice, everyone always complains that notice is too
16 short. I mean, it's sort of the complaint number one.
17 Well, actually, there has been pretty -- this has been
18 pretty good notice considering the rapid pace of this
19 industry. The word of mouth has gone out already. Our
20 pleadings and shortened time was approved on
21 December 24th. Everything went out to all creditors that
22 day. That was three weeks ago. We have a prospective
23 date for an auction bid of January 22nd, so that will be
24 approximately four weeks from the date the service and
25 notice went out. We have --

1 THE COURT: But no advertising has been done yet.

2 MS. GLYNN LEVIN: No. But as I said, we -- there
3 has been a company retained to blasts --

4 THE COURT: Right. But we don't get to go from
5 the original date. We get to go from, you know, today,
6 which is the 10th. So there is basically 12 days between
7 now and when you'd want to have the auction.

8 MR. VESSENE: No.

9 MS. GLYNN LEVIN: So the auction -- let me go back
10 to our dates. From today is the 10th. We would propose
11 to have bids in by noon on the 22nd, deposits for any
12 qualified bidders due on the 24th, and then an auction
13 to -- an auction at 9:00 in the morning on the 27th of
14 January. And I have checked with Mr. Murphy, and he is
15 available on the 27th as well.

16 MR. VESSENE: I have that number, Deirdre. I
17 have our price estimates for the rigs if the judge would
18 like to hear it.

19 MS. GLYNN LEVIN: Okay. Hold on to that.

20 I want to deal with a couple of -- well, deal
21 quickly with the objections of Soule, and then I am going
22 to go to look at Bitvestment's objections. Soule's
23 concerns was what are the assets being sold. I think we
24 are clear on that. There was some concern that there
25 was -- the quote was "an unfamiliar nature of the assets

1 being sold." And I guess familiarity really is in the
2 context of the person who is looking at this, because
3 those who are interested in these assets, this is not
4 unfamiliar at all to them. These are -- even the
5 investors, who are part of the -- who invested in the
6 debtor early on, they're not unfamiliar at all with
7 bitcoin. Everybody understands what bitcoin is.

8 THE COURT: Well, does the proposed order actually
9 describe the assets in detail? I mean, that's what I'm
10 going to be concerned about is what is the order --

11 MS. GLYNN LEVIN: I will ensure that we have an
12 exhibit that describes those assets in detail, yes.

13 We addressed the concern about is \$2,000 per
14 terra-hash the, quote, market value. And, again, you
15 know, market value is sort of an amorphous concept. It
16 is the floor price for an opening bid. It's not
17 necessarily the market value. And I say that in
18 quotation. We do anticipate that bringing in this floor
19 will generate a lot of interest, and the true market
20 value ultimately will be in the bidding process. This is
21 sort of truly capitalism at its best.

22 I want to turn to the objection of Bitvestment. I
23 think I've addressed Soule's concerns. Again, what is
24 Bitvestment? Where does it stand in this case? We don't
25 have any -- we only have one -- well, we have

1 administrative creditors and we have unsecured creditors.
2 Bitvestment is an unsecured creditor, no more, no less.
3 The value of its claim, proof of claim, \$8 million,
4 highly skeptical. The amount, the dollar amount that it
5 invested, I'm going to say this really slowly. \$75,000.
6 That is all it invested, and for all of that \$75,000 it
7 has created all this litigation, all this production, all
8 this objection, and is trying to basically squeeze the
9 debtor into forcing to continue to produce for it so
10 that -- to the jeopardy of the other creditors.

11 Thousands and thousands of pages of 2004 documents
12 were produced. Your Honor said it was onerous. It was
13 onerous. The timeline was onerous. And I really have to
14 add that it's pretty distressing to have taken the time
15 to have put together a 2004 motion so that we could find
16 out what's the basis of Bitvestment's claim. How does it
17 value it? We got a court order under 2004. Immediately
18 they turned around and said, "No. We're asking for
19 reconsideration." Your Honor denied that immediately.
20 We went ahead and said, "Great. There's no
21 reconsideration allowed. We want -- where are our
22 documents under 2004?" They were due under -- on
23 January 6th. We have not received one, and neither
24 counsel is willing to accept service of the subpoena. So
25 I think that might give Your Honor a flavor of the kind

1 of approach here. We're not dealing with a professional
2 approach here. In almost every other case that I've been
3 dealt with Counsel will willingly accept the service of
4 the subpoena.

5 Mr. Gallancy has refused to -- will not come to
6 Seattle for a 2004 exam. He's forcing us to expend the
7 debtor's resources to go to New York to the extent that
8 we -- and we will decide if that's necessary or not, to
9 have him deposed under 2004. But he won't -- no one will
10 accept the subpoena. I think that really does give a
11 flavor of what's gone on.

12 I think the Bitvestment objection, Your Honor,
13 really sort of has two parts. It's got the legitimate
14 parts. It's got the legs where it's really talking about
15 the sale, and I respectfully -- we've dealt with those,
16 but I respect those objections. I respect the fact that
17 they wanted us to continue to mine. I respect the fact
18 that they are looking out for their own client's best
19 interests. I mean, those are legitimate bases for
20 objections. You know, is it being sold? Is it being
21 sold to insiders? And I think we've dealt with them. We
22 don't even have insiders bidding. If they'd like to come
23 and stand and watch the bidding or if they'd like to come
24 bid, they are certainly welcome to do so.

25 The other part of the objection is really kind of

1 more a personal attack, and some of it is legitimate. I
2 can -- I understand their concerns about the
3 transparency. We have done our best to provide them all
4 the financial information that we believe that they're
5 entitled to. We have not held anything back. Some of it
6 was confidential. We wanted to ensure it was kept
7 confidential and not spread around the Internet like
8 trash. This is a court proceeding, and we did want to
9 maintain the integrity of that.

10 As to -- I want to mention also a couple of
11 things. As to the timelines, again, we can't really
12 stress enough that the timeline is really critical here.
13 We wouldn't have been working on the eve of the holidays,
14 Christmas and New Years, and asked Your Honor to deal
15 with this on either of those holidays if the timeline was
16 not critical. Moving this forward apace is in the best
17 interests of the estate. It is the way to maximize the
18 estate. And the debtor is really going to be at a loss
19 to figure out what to do after -- I mean, ultimately it's
20 going to have to turn the keys off if the staff people
21 walk away. It would not --

22 THE COURT: But the debtor could easily mine
23 bitcoin until the end of January and then do just that,
24 turn it off and auction the equipment.

25 MS. GLYNN LEVIN: The concern at that point is

1 we're going to have equipment that is going to have
2 nominal value. We'd be essentially selling it for scrap
3 so --

4 THE COURT: Why?

5 MR. VESSENE: But that's our schedule. The
6 schedule of the judge to --

7 MS. GLYNN LEVIN: Well --

8 MR. VESSENE: It is the schedule.

9 MS. GLYNN LEVIN: Well, it is --

10 MR. VESSENE: To turn it over on Feb 1 to the new
11 owner.

12 MS. GLYNN LEVIN: To sell it -- well, are you
13 proposing that we --

14 THE COURT: I mean, why does it become scrap --

15 MS. GLYNN LEVIN: Are you proposing that we --

16 THE COURT: -- if it stops operating?

17 MS. GLYNN LEVIN: Our schedule is -- well, I want
18 to make sure we're not dealing with semantics here. Our
19 schedule --

20 THE COURT: It is not scrap.

21 MS. GLYNN LEVIN: Our schedule is to allow a new
22 owner to take it over and actually have a sale close
23 exactly as Your Honor has proposed.

24 THE COURT: Okay.

25 MS. GLYNN LEVIN: The end of January. I thought

1 Your Honor was suggesting that we stop this process and
2 start the process of a sale after that time.

3 THE COURT: I guess what I'm suggesting is based
4 upon the way you've described this equipment to me, it
5 doesn't sound like it becomes scrap unless the market
6 completely collapses. That whether you stop today or the
7 end of January or the end of February, you still have a
8 system which can operate.

9 MS. GLYNN LEVIN: Right. And it --

10 THE COURT: In other words, it's not scrap --

11 MS. GLYNN LEVIN: But it's --

12 THE COURT: -- at any time.

13 MS. GLYNN LEVIN: It's a --

14 THE COURT: It's just about the market and whether
15 the cost of that equipment is -- the value of that
16 equipment is going to go up or down. But in other words,
17 it's not like -- well, okay. Let me give you a better
18 example. It is not like a retail store which loses value
19 immensely as soon as it closes.

20 MS. GLYNN LEVIN: Well, as soon as it stops
21 operating --

22 THE COURT: Right.

23 MS. GLYNN LEVIN: -- it does lose value because --

24 THE COURT: Whereas if you stop operating this
25 system, there is no evidence in the record that indicates

1 that somehow it loses all of its value just because the
2 switch is turned off, right? You can still sell it to
3 someone who can turn the switch on.

4 MS. GLYNN LEVIN: The buyers, in my
5 understanding -- and, again, I have to refer to my client
6 because this is a -- such a technical industry. And I
7 have learned as much as I possibly can, but buyers are
8 going to want to be able to walk in and have an operating
9 system in a hosted environment. That is what they are
10 looking for, and to be able to say, "Here is your cold,
11 dark stuff in a warehouse," is not going to generate the
12 kind of sale proceeds that we are looking for.

13 THE COURT: So when they walk in, they're going to
14 want to do business with CoinLab. They're going to want
15 to hire Mr. Vessenes, and they're going to want to hire
16 these other three people because this is the kind of
17 business where you've got to buy it in operating form?

18 MS. GLYNN LEVIN: They --

19 THE COURT: Is that what you're saying?

20 MS. GLYNN LEVIN: I'm not necessarily saying
21 anything about the Human Resources that are going to be
22 attached, no. If a buyer wants --

23 THE COURT: And they're going to need to take over
24 these leases --

25 MS. GLYNN LEVIN: Yes.

1 THE COURT: -- that CoinLab has executed.

2 MS. GLYNN LEVIN: If a buyer wants to negotiate a
3 separate contract to have the individuals who are
4 familiar with the equipment do so, that is up to the
5 buyer and that is up to -- that is not part of our sale.

6 THE COURT: Well, I mean, I want to make sure I
7 understand what you're saying. Because you're either
8 saying this is equipment that cannot be moved and it must
9 be operated where it is located, or it's equipment that
10 you bring in a big truck and you can ship it to Australia
11 if you want. Which is it?

12 MS. GLYNN LEVIN: It may be moved, but "may" is
13 the operative word. The reality is that the buyers will
14 not want to move it. It's highly sensitive. It's very
15 expensive. It needs to be maintained under special
16 conditions. There are already places where it is set up.
17 So it would be like picking up, you know, an auto parts
18 factory. Yeah, you could have it in Seattle or you could
19 have it in Gainesville, Florida, but do you want to? No.
20 You want to have it exactly where it is. You don't want
21 to move --

22 THE COURT: Okay.

23 MS. GLYNN LEVIN: -- the -- you don't necessarily
24 want to move it.

25 MR. VESSENES: It's lost revenue too.

1 MS. GLYNN LEVIN: The cost it would -- the buyer
2 would incur that cost, so it would make no economic sense
3 for a buyer to pick it up and want to move it. Besides,
4 the production of it creates virtual -- a virtual product
5 which can be used anywhere. It's not like it's
6 producing -- you know, pumping out a concrete product
7 that has to then be picked up and shipped and sold. So
8 these buyers, who will be coming in from all over the
9 world, probably don't -- may not care where it is, but
10 are -- probably would be very happy to know that there
11 are existing contracts that they can consider stepping
12 into, and if they're qualified can go ahead and negotiate
13 with those hosting providers to continue to operate the
14 rigs in those locations.

15 And Ms. Pearson can address that a little bit
16 more, as she -- I know she's taken a little bit of time
17 to -- although she's only been recently retained in this
18 case, she's taken a little bit of time to try to
19 understand those leases.

20 Before the hearing today, I provided copies to
21 Mr. Stehlik and counsel for Bitvestment on a proposed
22 appendix, which has -- appendix to the order, which has
23 an outline of sort of sale procedures. And I'm happy to
24 turn to those, but I think maybe it's time to allow my
25 opposing counsel to speak or my cocounsel.

1 THE COURT: Well, let me ask -- I want to ask one
2 more. I have a couple -- I want to make sure I asked all
3 my questions. I guess I don't understand how the mining
4 works such that when the November monthly report was
5 filed on December 17th, it showed no revenue, and it
6 wasn't until the day after Mr. Vessenes's deposition that
7 it was amended to show \$1.8 million.

8 MS. GLYNN LEVIN: Well, the fact that the
9 deposition intervened was really kind of a coincidence.
10 Actually asking to -- asking us to clarify the statement
11 of financial affairs had nothing to do with Bitvestment
12 at all. It had to do with the U.S. trustee, who said,
13 "Can you help us clarify this so" -- and we did, and we
14 amended it. And we amended it, I think, just to --

15 THE COURT: Okay. You missed my question. My
16 question is about bitcoins --

17 MS. GLYNN LEVIN: Yes.

18 THE COURT: -- and how you know when you've
19 actually mined them.

20 MS. GLYNN LEVIN: Yes. So --

21 THE COURT: Okay? So let me finish.

22 MS. GLYNN LEVIN: Yes.

23 THE COURT: On December 17 when this report is
24 filed, you either know or you do not know how many
25 bitcoins have been mined. And I don't know how the

1 process works. Is it a surprise? You don't find out
2 until 30 days later how much you've mined or --

3 MS. GLYNN LEVIN: No. No.

4 THE COURT: -- you can't calculate it?

5 MS. GLYNN LEVIN: No.

6 THE COURT: Well, how do you do it?

7 MS. GLYNN LEVIN: So there really -- there are two
8 questions here. There's no surprise. It's not like
9 opening up your stocking Christmas day and wondering
10 what's in there.

11 THE COURT: But it is an algorithm.

12 MS. GLYNN LEVIN: No.

13 THE COURT: So you don't know exactly when you're
14 going to get one?

15 MS. GLYNN LEVIN: You -- well, yes. In fact,
16 there is some predictability --

17 THE COURT: All right.

18 MS. GLYNN LEVIN: -- in that extent. You know
19 when you've earned it. You don't know when you're going
20 to earn it, but you know -- when you have earned it, it's
21 clear. It's in your account.

22 THE COURT: Okay.

23 MS. GLYNN LEVIN: And I want to make one point
24 because this trumped me a couple of times, and that is
25 the -- these accounts, the deposits in the accounts

1 under -- for bitcoin are timed as of Greenwich Mean Time
2 because this is an international system. So there may
3 have been -- there may be a deposit in the account, let's
4 say, on -- you know, on a Tuesday. Now, Greenwich Mean
5 Time, it's a ready Wednesday. In Seattle, it may be
6 still Tuesday depending on the time of day.

7 THE COURT: I get all of that, but you filed a
8 monthly report in the middle of December which said, "We
9 earned no income." Zero. Meaning nothing.

10 MR. VESSENE: It's Moss Adams' recommendation.

11 MS. GLYNN LEVIN: So I'll get to that.

12 MS. SIMONYAN: Your Honor, I object to
13 Mr. Vessenes' testifying.

14 MS. GLYNN LEVIN: Okay.

15 THE COURT: Well, he's not testifying. I mean,
16 here's the problem. I am being left with the impression
17 that Mr. Vessenes got caught at his deposition when
18 confronted with these numbers and had to disclose them --

19 MS. GLYNN LEVIN: No.

20 THE COURT: -- that, in fact, the company had
21 earned \$1.8 million. And the debtor needs to do
22 something to dispel that impression.

23 MS. GLYNN LEVIN: No. That really is not the case
24 at all, and I do need to clarify this. And we have
25 counsel for the U.S. trustee here. Why is he here?